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ILLINOIS POWER COMPANY

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 04-0677

REVISED REBUTTAL EXHIBITS SPONSORED BY SCOTT GLAESER

JANUARY 20, 2006

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Witness (Public)

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ILLINOIS COMMERCE COMMISSION

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REVISED REBUTTAL TESTIMONY OF SCOTT A. GLAESER

JANUARY 20, 2006

I. INTRODUCTION AND WITNESS QUALIFICATIONS

1 Q. Please state your name, business address and present position.

2 A. My name is Scott A. Glaeser; my business address is One Ameren Plaza, 1901
3 Chouteau Avenue, St. Louis, Missouri, 63103. I am currently Vice President, Gas
4 Supply and System Control for Ameren Energy Fuels and Services Company, a
5 wholly owned subsidiary of the Ameren Corporation ("Ameren").
6

7 Q. Please summarize your educational and employment background.

8 A. I received a Bachelor of Science Degree in Mechanical Engineering from the
9 University of Missouri at Rolla in December of 1986. From 1987 to January 1991 I
10 was a Combustion Engineer for the Granite City Steel Division of National Steel
11 Corporation (now U.S. Steel Corporation). In February of 1991, I accepted the
12 position of Fuel Buyer for Union Electric Company ("UE") in which I was
13 responsible for the purchase of natural gas for the company's gas distribution systems
14 and gas-fired generation. In 1994 I was named Engineer, Gas Supply and Planning,
15 with continuing responsibilities for obtaining reliable and economical gas supply,
16 transportation and storage services for UE's gas distribution systems and gas-fired
17 generation. During 1997 and 1998, in addition to my duties related to the natural gas

18 business, I also acted as a short-term power trader for UE. In March of 1998, after the
19 merger of the parent company of Central Illinois Public Service Company with UE,
20 which formed Ameren, I was promoted to the position of Supervising Engineer of
21 Gas Supply and Transportation in Ameren Services Company. In July of that year I
22 was promoted to Manager of the Gas Supply and Transportation Department. In
23 November of 2000 I was directly involved with the formation of Ameren Energy
24 Fuels and Services Company ("AFS") by the consolidation of the Gas Supply and
25 Transportation Department and the Fossil Fuels Department. AFS is charged with
26 managing natural gas and generation fuel resources for all Ameren affiliated
27 companies including Ameren's gas distribution utilities and power generation
28 companies. In this position, I continued with management responsibilities over
29 business activities including gas supply acquisition, price hedging, transportation and
30 storage capacity acquisition, system operations, and regulatory affairs for AmerenUE,
31 AmerenCIPS, AmerenCILCO, and AmerenEnergy Generating Company. In October
32 2004 my function became responsible for the same activities for the Illinois Power
33 Company ("Illinois Power", "IP" or "AmerenIP") gas distribution operations.

34 In October of 2004, I was promoted to my current position of Vice President,
35 Gas Supply and System Control for Ameren Energy Fuels and Services Company.
36 My current responsibilities include all duties included in my previous position plus
37 the management and oversight of the Gas Control function and the End-User
38 Transportation function located in Springfield, Illinois.

39 Q. Have you previously testified before the Commission?

40 A. Yes. I have testified either in person or through the submission of written prepared
41 testimony before this Commission several times, most recently in ICC Docket No. 03-
42 0699 and ICC Docket No. 04-0294, which are AmerenIP's 2003 PGA reconciliation
43 proceeding and the proceeding approving the acquisition of IP by Ameren,
44 respectively.

45 **II. PURPOSE AND SCOPE**

46 Q. What is the subject of your testimony in this case?

47 A. My rebuttal testimony is focused on Staff witness Mr. Eric Lounsberry's proposed
48 disallowance. Specifically, my rebuttal testimony will (1) discuss the Commission's
49 standard of prudence and the application of that standard by Mr. Lounsberry in this
50 case; (2) explain Ameren's due diligence process prior to its acquisition of Illinois
51 Power, specifically with respect to IP's gas storage fields; (3) explain Ameren's
52 reasons for negotiating indemnification provisions with respect to certain gas-related
53 matters in the Stock Purchase Agreement with Dynegy Inc. for the acquisition of IP;
54 and (4) respond to Mr. Lounsberry's citation of certain Ameren testimony from ICC
55 Docket 04-0294 regarding staffing levels at IP's gas storage facilities. Other
56 AmerenIP witnesses - Messrs. Shipp, Hood, Kemppainen and Hower - provide
57 detailed testimony responding to the specific issues raised by Mr. Lounsberry in his
58 direct testimony.

59 **III. STANDARD OF PRUDENCE**

60 Q. What is your understanding of the Commission's standard of prudence?

61 A. It is my understanding that the Commission has adopted the following standard of

62 prudence:

63 Prudence is that standard of care which a reasonable person
64 would be expected to exercise under the same circumstances
65 encountered by utility management at the time decisions had to be
66 made. In determining whether a judgment was prudently made, only
67 those facts available at the time judgment was exercised can be
68 considered. Hindsight review is impermissible.

69
70 Imprudence cannot be sustained by substituting one's judgment
71 for that of another. The prudence standard recognizes that reasonable
72 persons can have honest differences of opinion without the one or the
73 other necessarily being "imprudent." (Illinois Commerce Commission
74 v. Commonwealth Edison Co., ICC Docket 84-0395 (Order issued
75 Oct. 7, 1987), p. 17.)
76

77 It is also my understanding that the Commission as well as the Illinois courts have
78 recognized that human errors are unavoidable and that the commission of some errors
79 in an activity does not necessarily mean that a utility was imprudent (e.g., Order in
80 ICC Docket 84-0395, p. 19).

81 Q. Do you believe that Mr. Lounsberry is properly applying the prudence standard in
82 recommending his proposed disallowances in this case?

83 A. No, I do not. I believe Staff witness Lounsberry's opinion that IP was imprudent in
84 the actions it took to investigate the decline in deliverability of its Hillsboro Storage
85 Field ("Hillsboro" or "HSF") are based on hindsight and do not adequately take into
86 account the circumstances faced by IP at the time the decisions and actions at issue
87 were being made. His recommendations are based on an after-the-fact analysis of
88 what he thinks IP should have done or should have known based on certain
89 information (to the exclusion of other information that IP had to take into account) at
90 particular points in time. Mr. Lounsberry also greatly oversimplifies the difficulties

91 associated with evaluating the multiple potential causes of the Hillsboro deliverability
92 problems and eliminating potential causes to arrive at the actual cause or combination
93 of causes. His analysis fails to adequately take into account that underground storage
94 reservoirs such as Hillsboro are complex geological systems whose characteristics
95 cannot be known with complete certainty. AmerenIP witnesses Hood, Kemppainen
96 and Hower address these topics in detail in the context of the Hillsboro-specific
97 issues.

98 Q. Do you have any other concerns about Mr. Lounsberry's application of the prudence
99 standard in this case to produce his proposed disallowances?

100 A. Yes. I believe that Mr. Lounsberry's recommended imprudence disallowance in this
101 case, like his recommended disallowance in AmerenIP's 2003 PGA reconciliation
102 case, ICC Docket 03-0699, introduces a level of risk to the gas distribution business
103 that is inconsistent with the level of reward that AmerenIP has the opportunity to earn
104 from this regulated business. For example, in 2004 IP had total purchased gas costs of
105 over \$336 million, which is equal to about 70% of IP's total gas utility operating
106 revenues. Illinois Power earns no return on the sale of this gas to customers and earns
107 no return for acquiring this gas for its customers. IP's return on its gas utility business
108 is earned only from the allowed rate of return applied to its assets included in rate
109 base. In 2004, Illinois Power had net gas utility income of approximately \$29.1
110 million, which represented only about a 6.1% margin on its gas operating revenues.
111 Mr. Lounsberry's proposed imprudence disallowance of more than \$2.9 million in
112 this case represents about 10% of IP's total gas operating income. Thus, Mr.

113 Lounsberry's proposed disallowance imposes a very substantial risk of loss on IP's
114 relatively modest rewards from the gas utility business.

115 From a policy perspective I believe the Commission should have grave
116 concerns about the message being sent to gas utilities in Illinois if Mr. Lounsberry's
117 proposed disallowance is approved. I believe that other utilities that operate gas
118 storage facilities would look at the testimony of Messrs. Hower, Shipp, Kemppainen
119 and Hood, compare it to Mr. Lounsberry's testimony and conclude that Ameren
120 prudently managed the Hillsboro Storage Field but yet the Commission still ordered a
121 disallowance. Then they would logically look at their own operations and question
122 the risk they have in the continued operations of their storage facilities. They would
123 also have to factor in this additional risk if they were contemplating the further
124 expansion or initial development of additional storage capacity.

125 During a period of record high gas prices, extreme price volatility, and
126 potential gas shortages, the expansion of storage capacity should be strongly
127 supported and encouraged by the industry and regulatory agencies. Storage is a
128 primary factor affecting gas prices (as evidenced, for example, by the effects on
129 NYMEX futures prices when the Energy Information Administration weekly storage
130 inventory report is released) and is an important tool for gas utilities to employ in
131 order to dampen price volatility and reduce the risk of supply shortages during the
132 critical winter operating season. At the national level, the development of storage
133 capacity is strongly encouraged as one of several key solutions to the crisis the gas
134 industry is facing in this country. For example, Congress in Section 312 of the

135 Energy Policy Act of 2005 has authorized FERC to authorize natural gas companies
136 to provide natural gas storage and storage-related services from new storage facilities
137 at market-based rates, even where the company cannot demonstrate that it lacks
138 market power, if FERC determines that market-based rates are in the public interest
139 and necessary to encourage the construction of gas storage capacity in an area needing
140 storage services.

141 It is clear that storage should be expanded in the U.S. to help mitigate price
142 volatility and price spikes the country has endured since the winter of 2000/2001. At
143 a time when storage capacity should be expanded and enhanced for the ultimate
144 benefit of customers, a decision to impose a disallowance based upon the evidence in
145 this case would create an atmosphere of uncertainty and additional risk which I
146 believe would discourage further development of gas storage facilities in Illinois.

147 **IV. AMEREN'S PRE-ACQUISITION DUE DILIGENCE**

148 Q. Beginning at the bottom of page ⁴⁴~~38~~ of his direct testimony, Mr. Lounsberry quotes
149 from a "due diligence" report prepared by Ameren in connection with its investigation
150 of whether to acquire Illinois Power. Are you aware of the report he cites?

151 A. Yes, I am. I was part of the Ameren acquisition team that was responsible for
152 performing due diligence during Ameren's investigation and negotiations concerning
153 the possible purchase of Illinois Power from Dynegy. In fact, I was the co-author of
154 the specific document Mr. Lounsberry quotes, "Due Diligence Analysis of Illinois
155 Power's Gas Supply and System Operations".

156 Q. Mr. Lounsberry states it is his opinion that Ameren's own due diligence report

verifies his conclusion that "IP is unwilling to spend capital on its storage activities"
(Staff Exhibit 2.00, page 45). Do you agree with his assessment?

A. No, I do not, for several reasons. First, the due diligence process is a difficult process
with several purposes from the potential buyer's perspective. A primary purpose is to
identify and quantify as many negatives and concerns as possible about the company
or assets under consideration for purchase, as a basis for negotiating the acquisition
price or to terminate the acquisition. In addition, all possible risk exposures must be
identified and analyzed with limited time and incomplete information in order to
determine the maximum possible risk scenario, even if the risks turn out later to be
minor or nonexistent. Of course the selling party wants just the opposite and in an
attempt to "protect" its positions seeks to limit the potential purchaser's due diligence
process by limiting the scope of the investigation and access to its assets, records, and
personnel. In the same paragraph from the due diligence report in which Mr.
Lounsberry extracted the sentence addressing IP's capital expenditures on storage was
another sentence that described the short and restricted nature of the due diligence
process with Dynegy. The additional sentence reads: **BEGIN CONFIDENTIAL**

*******END**

CONFIDENTIAL This statement makes clear that the limited amount of
information, time, and access to key personnel available to Ameren's acquisition team
by Dynegy resulted in an imperfect understanding of the operating risks and capital
expenditures associated with the Hillsboro Storage Field and Illinois Power's other

179 storage fields. The end result is that “due diligence” conclusions are based on
180 incomplete or imperfect information, but they are made with the objective of
181 providing a basis for negotiating a favorable purchase price. The statement from the
182 due diligence report quoted by Mr. Lounsberry must be considered with that context
183 in mind.

184 Q. Post close, what is your current opinion of IP’s historic capital spending practices at
185 its storage facilities?

186 A. Detailed integration of Illinois Power into Ameren began immediately after the
187 September 30, 2004 close of the acquisition. At this time, Ameren management
188 began to have full access to Illinois Power’s assets, personnel, and records. The
189 detailed integration activities uncovered no evidence that IP’s capital spending at its
190 gas storage fields has been inadequate. In fact, examining the total expenditures for
191 the storage fields, which includes capital and O&M expenses, reveals relatively stable
192 total expenditures with some variations due to larger capital projects in certain years
193 (replacement of major equipment such as generators or boilers). These expenditure
194 variations are to be expected when managing complex physical assets with large
195 mechanical components which are replaced from time to time but not every year.
196 There was no evidence of needed capital projects that were rejected or deferred due to
197 capital spending constraints and no evidence that capital projects were not
198 implemented in a timely manner.

**V. DYNEGY INDEMNIFICATION IN STOCK
PURCHASE AGREEMENT**

Q. Beginning at line 1208 (page 58) of his direct testimony, Mr. Lounsberry introduces some additional evidence that he deems "pertinent" to this case, specifically, the existence of an indemnification clause in the Stock Purchase Agreement between Ameren and Dynegy for the acquisition of IP. Mr. Lounsberry states that Ameren included this provision in the Stock Purchase Agreement because "it was so concerned about the manner that IP and Dynegy had operated the field". Is his assessment accurate?

A. No, it is not. First, the inclusion of an indemnification provision in an acquisition agreement is the product in part of the uncertainties inherent in the due diligence process, as I have described, as well as the uncertainties inherent in the outcome of litigation that is pending or may result from events prior to the acquisition date. Indemnification provisions in acquisition agreements are commonly used as a way for the parties to share or allocate the risks associated with such uncertainties. There are of course other methods that can be used to share or allocate such uncertainties including adjusting the purchase price, providing for additional working capital adjustments, or giving up indemnification rights in return for other unrelated consideration. Of course, the resulting final acquisition agreement is the product of extensive, arms'-length negotiations. In this case, the parties negotiated to have an indemnification provision covering specific litigation and regulatory matters as opposed to one of the alternative approaches.

I note that Mr. Lounsberry has quoted only a small portion of the indemnification provision in the Stock Purchase Agreement. The indemnification section of the Stock Purchase Agreement is more than seven pages long, not including attachments. Additionally, one of the schedules referenced in the indemnification section lists over 40 pages of potential litigation exposure. These indemnifications of potential risk exposures cover all aspects of IP's utility business including environmental issues, tax issues, outstanding lawsuits, and warranties and representations by Seller. Mr. Lounsberry's attempt to isolate one indemnification clause from this extensive list of indemnifications as evidence of imprudence on the part of IP is misleading and misrepresents the purpose of indemnification clauses.

Q. Why were the open PGA cases and the Hillsboro Storage Field inventory issue specifically identified in the indemnification provision in the Stock Purchase Agreement?

A. With respect to the open PGA cases, Ameren did not think it should bear 100% of the risk of possible disallowances in the open reconciliation proceedings relating to reconciliation periods prior to the closing of the acquisition while IP was under the control of Dynegy. With respect to the provisions relating to Hillsboro Storage Field, at the time we were negotiating to acquire IP (late 2003-early 2004), Illinois Power had recognized that an inventory adjustment was necessary at Hillsboro and that some portion of the base gas had probably been withdrawn and supplied to customers, but IP had not finally determined the actual amounts or the plan for recovery. Our concerns focused on the risks associated with obtaining cost recovery in future

243 periods for the consequences of past events.

244 Finally, I would place a different construction on the indemnification
245 provision than does Mr. Lounsberry. Specifically, Ameren was sufficiently
246 unconcerned about risks associated with the open PGA cases and the Hillsboro
247 Storage Field issues that it was willing to agree to a 50-50 sharing of those risks with
248 Dynegy rather than insisting that Dynegy bear 100% of the risks.

249 **VI. TESTIMONY CITED BY MR. LOUNSBERRY**
250 **FROM ICC DOCKET NO. 04-0294**

251
252 Q. At lines 885 to 899 of his direct testimony, Mr. Lounsberry refers to certain testimony
253 of an Ameren witness in the proceeding for approval of Ameren's acquisition of IP
254 (ICC Docket No. 04-0294) and comes to the conclusion that it indicates "Ameren
255 shared some of Staff's concerns regarding the level of oversight that IP had over its
256 storage operations". Do you agree with the conclusion Mr. Lounsberry draws from
257 the testimony he cites from ICC Docket No. 04-0294?

258 A. No. Mr. Lounsberry is referring to the rebuttal testimony of Ameren witness Jimmy
259 L. Davis filed on July 20, 2004, in ICC Docket No. 04-0294. I was an integral part of
260 the review team at Ameren which was tasked with making recommendations to
261 Ameren's executive management concerning the acquisition of IP's gas storage fields,
262 and in fact I participated in the development of Mr. Davis' testimony in ICC Docket
263 No. 04-0294. Here is the actual testimony of Mr. Davis to which Mr. Lounsberry is
264 referring:

265 Ameren is familiar with the concerns raised by Staff in the IP
266 2001 PGA reconciliation (ICC Docket 01-0701) and also identified in

Mr. Lounsberry's testimony which discusses the staffing levels at the IP storage fields. If the Commission approves Ameren's acquisition of IP, Ameren will control 12 storage fields with a combined storage plant in service of approximately \$140 million. Ameren recognizes that these storage assets are critical to the continued ability of Ameren to provide safe, reliable, and economic gas service to our customers and takes the management of these assets seriously. Upon closing of the transaction, Ameren will establish a manger level position to lead its storage organization. In addition to a manager position, Ameren expects, within six months of closing, to add engineering and supervisory personnel who will focus on storage activities and responsibilities. These positions will be in addition to the existing storage personnel at Central Illinois Public Service Company d/b/a AmerenCIPS, Central Illinois Light Company d/b/a AmerenCILCO, and IP.

As you can see, while Mr. Davis indicated that Ameren was familiar with the concerns Mr. Lounsberry had identified in prior testimony, Mr. Davis did not state that Ameren "shared" or agreed with Mr. Lounsberry's concerns relating to the staffing of IP's storage facilities. In addition, while (as Mr. Lounsberry as well as Mr. Shipp describe), IP's staffing of its storage fields during the period focused on by Mr. Lounsberry in this case, 1999 through 2001, was based on a manpower plan developed and adopted by IP in 1995, Ameren's post-acquisition plans described in Mr. Davis' testimony were based on Ameren's evaluation of the staffing of IP's storage facilities in 2004 and of the management and staffing needs for the entire Ameren storage field operation when IP's storage operations were integrated with those of the existing Ameren companies. It was not based on an evaluation of the appropriateness of IP's gas storage staffing and organization in earlier years. The most important factor in Ameren's evaluation was the need to reorganize all of its gas storage field operations post-acquisition (including the AmerenCIPS and

AmerenCILCO fields as well as the AmerenIP fields) into an organization consistent with the overall Ameren management structure.

Q. Are there policy reasons why the Commission should give the testimony cited by Mr. Lounsberry from ICC Docket No. 04-0294 no weight in this reconciliation proceeding?

A. Yes. In ICC Docket No. 04-0294, Ameren stated that it would evaluate and potentially make changes in the areas identified by Mr. Lounsberry. This was done in an effort to cooperate with Staff as well as to expedite approval and closing of the acquisition of IP, and with the knowledge that the Commission could impose conditions on its approval of Ameren's acquisition of IP. Now, we find Ameren's positive response to Staff and its commitment to action in ICC Docket No. 04-0294 being cited by Staff against Ameren as evidence of imprudence in a prior period. If the Commission were to use Ameren's testimony cited by Mr. Lounsberry from ICC Docket No. 04-0294 as evidence of imprudence in this case, then in the future utilities could be reluctant to take actions in response to Staff recommendations concerning management, staffing and operations, for fear that Staff would then cite the utility's positive actions against it as evidence that the previous management, staffing or operational structure or practice involved was imprudent.

Q. Does this conclude your prepared rebuttal testimony?

A. Yes, it does.